Economics

DBS Flash

China: Slowing growth along with signs of stabilization

Economics/Strategy/Rates/FX

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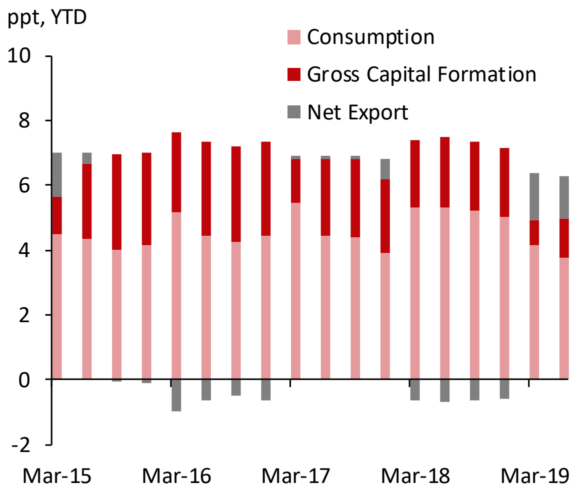
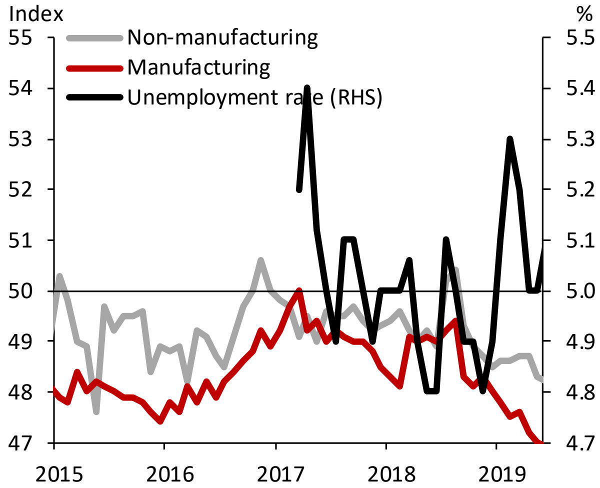
- *Real GDP growth eased to 6.2% in 2Q19 from 6.4% YoY in 1Q19*
- ***Implication for our forecast**: We maintain our forecast for China's GDP to grow by 6.2% in FY19*
- ***Implication for our investors**: Onshore interest rates and CNY exchange rate may see further downward pressure.*

Chart 1: Contribution to GDP growth



Source: CEIC, DBS Group Research

Chart 2: Employment PMIs and unemployment rate

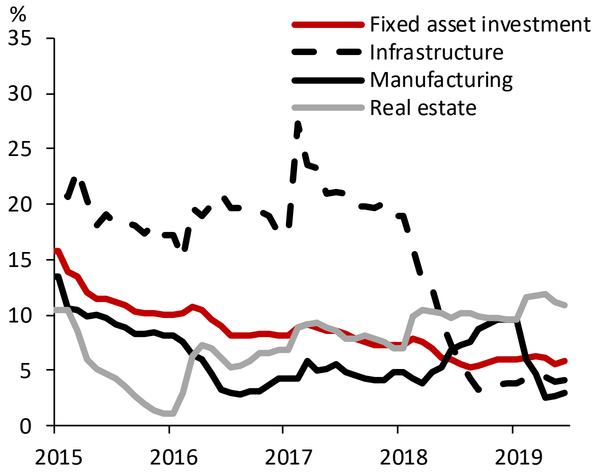


Note: Surveyed Unemployment rate in Urban Areas is only available since Jan17. Source: CEIC, DBS Group Research

Real GDP growth decelerated to 6.2% in 2Q19 from 6.4% YoY in 1Q19 (Chart 1), the slowest rate of growth since the 1990s. In fact, final consumption expenditure decelerated for a fourth quarter in a row (3.8% YoY YTD) in spite of numerous fiscal stimulus measures.

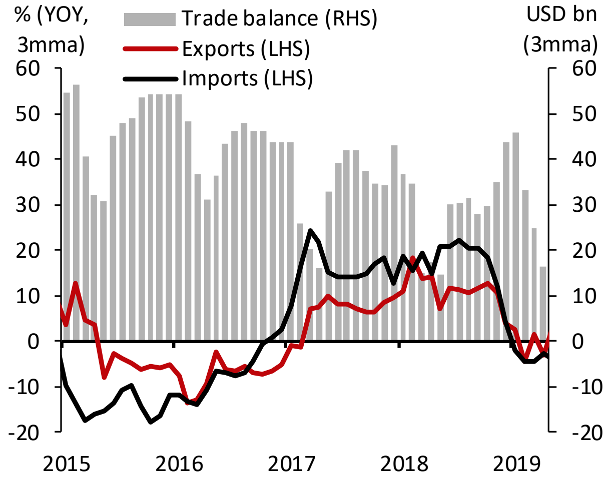
Recovery of private consumption remains uncertain in the second half of the year. Supply of discretionary products such as automobiles contracted for the 7th consecutive month at 15.2% YoY in June. Consumer confidence will likely weaken further due to subdued income growth alongside a softening labour market. The employment PMI index for manufacturing sector went down further to the 10 year-low of 46.9. Non-manufacturing also fell for the 10th consecutive month to a 49-month low of 48.2 (Chart 2). Unemployment rate inched up to 5.1%, above the 5.0% threshold for over 5 months. This will exert downward pressure on wages over time.

Chart 3: Fixed asset investment (YTD)



Source: Bloomberg, DBS Group Research

Chart 5: Merchandise trade



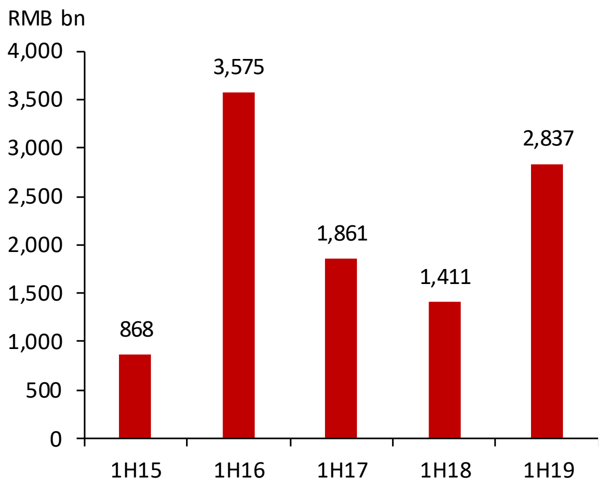
Source: CEIC, DBS Group Research

More stimulus will be rolled out to encourage spending. For instance, authorities are set to cut purchasing taxes for cars and ease the auto license quota.

The investment environment has somewhat stabilized, with fixed asset investment (FAI) inching up slightly by 0.2% point to 5.8% in June. Manufacturing investment only improved mildly to 3.0% YoY YTD from 2.7% in May (Chart 3), compared with 9.5% in 2018 YTD. Infrastructure investment edged up by 0.1% point to 4.1% in 1H19 from the first five months. We expect it to accelerate in 2H19 as more projects are rolled out by NDRC. Local government bonds, as main source of funding for infrastructure, has been rising (Chart 4). Its cumulative issuance jumped 46.4% from May. Coupled with the relaxation of the use of government debt, the FAI is set to improve. Real estate investments fell further to 10.9% from 11.2% in May. This was in line with the decelerating floor space sold (down to 1.2% from 0.9%) and subdued property price (down to 10.8% from 11.3%). This is expected to decelerate further as enforcement on the property market curbs remain.

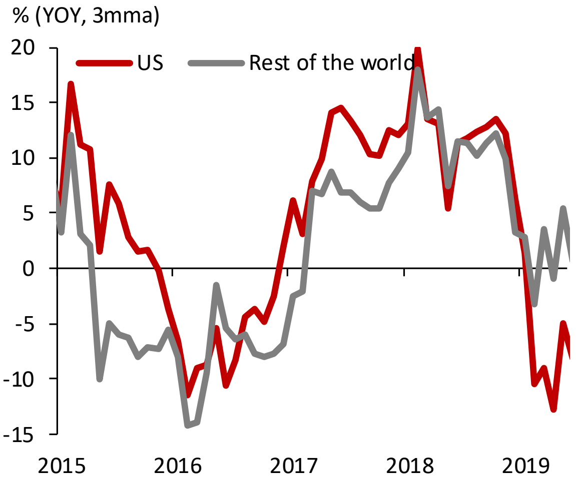
On the external front, China's exports fell 1.3%, down from 1.1% in May (Chart 5). NBS Manufacturing PMI's new export order

Chart 4: Local government bond issuance



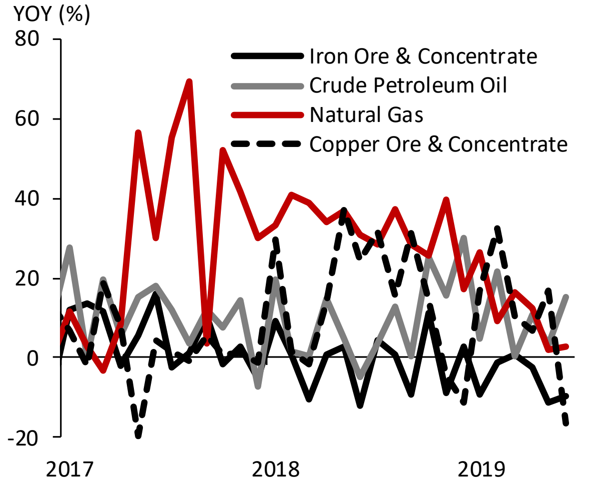
Source: CEIC, DBS Group Research

Chart 6: Exports to US and rest of the world



Source: CEIC, DBS Group Research

Chart 7: Imports by selected commoidty

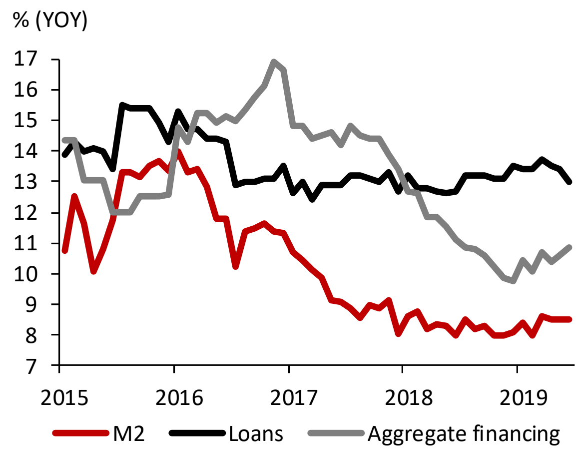


Source: CEIC, DBS Group Research

component also fell to 46.3 from 46.5, remaining in the contraction zone for the 13th consecutive month. Exports to advanced economies was sluggish: to the EU dropped by -3.0% from 6.1%. Existing tariffs also dragged down exports to the US by 7.8% in June, compared with -4.1% in May. Yet, the trade balance against the US increased to USD29.9bn from USD26.9bn due to slumping imports (-31.4%) (Chart 6).

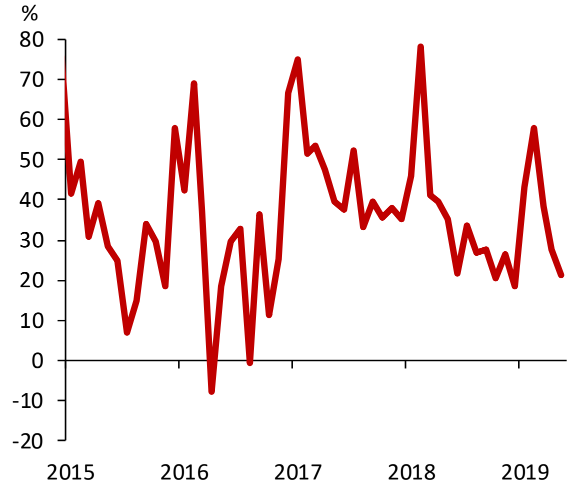
The story on the imports end mirrors subdued domestic demand. Inward shipments of electronics related goods had been falling. For instance, imports from South Korea and Taiwan, the global electronics suppliers, fell noticeably by 21.9% and 7.4%. Raw material imports for industrial production have weakened over a year earlier: coal, iron ore, and copper were respectively benign at 6.4%, -9.7% and -16.5% (compared to 23.0%, -11.0%, and 16.7% respectively) (Chart 7).

Chart 8: M2, loans, and aggregarate financing (outstanding)



Source: CEIC, DBS Group Research

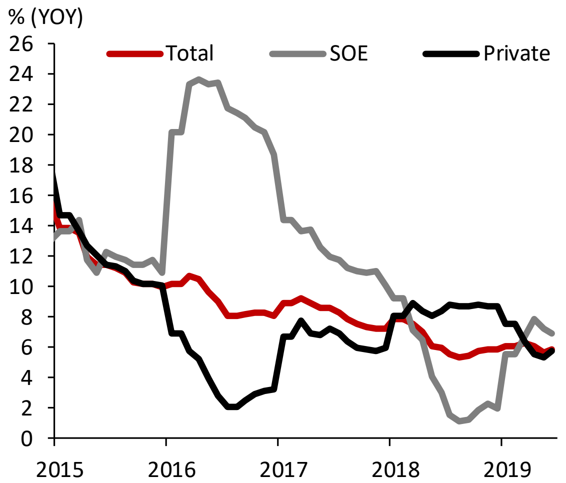
Chart 9: Corp. long term loan/total loan



Source: CEIC, DBS Group Research

As trade income dwindled, the supply of money also contracted in tandem. M2 grew by 8.5% (Chart 8) for the third month in a row despite the cuts in required reserve ratio (RRR) announced in May. Growth of M1 remained tepid at 4.4%. Even though outstanding aggregate financing improved from 10.6% in May to 10.9% in June, long-term corporate loan as percentage of total loan continued to drop (Chart 9), suggesting a conservative investment environment. Likewise, the FAI was primarily driven by State Owned Enterprises while that of Private Owned Enterprises stayed below 6% for three months (Chart 10). Authorities will continue to impose targeted measure to unclog funding channels to companies which are more affected by the China-US trade war. We expect two more RRR cuts in the 2H19.

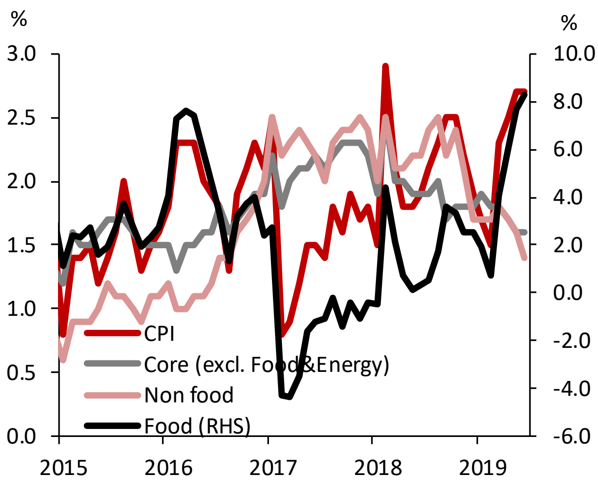
Chart 10: Fixed asset investment (YTD)



Source: CEIC, DBS Group Research

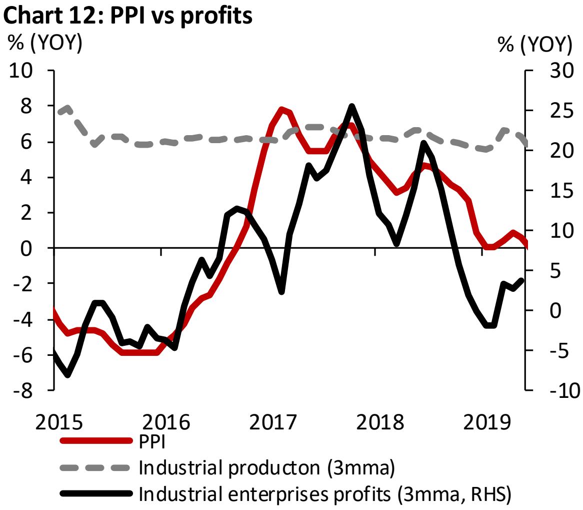
On the inflation front, June's reading was on par with May at 2.7% YoY (Chart 11). Food inflation, as the biggest element after housing in the CPI, continued to soar, at 8.3%. This is the highest inflation since Jan 12. Pork (amounting to 2.5% of the total inflation basket) prices jumped by 21.1% YoY, also the strongest growth since May 16. Although the government has spared no effort to contain the swine fever, food prices are likely to stay elevated due to tight supplies. The MoM changes in pig stock drop further to -4.2% in May. On a YoY basis, it fell by 22.9%. Likewise, fruit prices surged by 42.7% from 26.7% in May due to the weather condition last year.

Chart 11: CPI by category



Source: CEIC, DBS Group Research

Chart 12: PPI vs profits

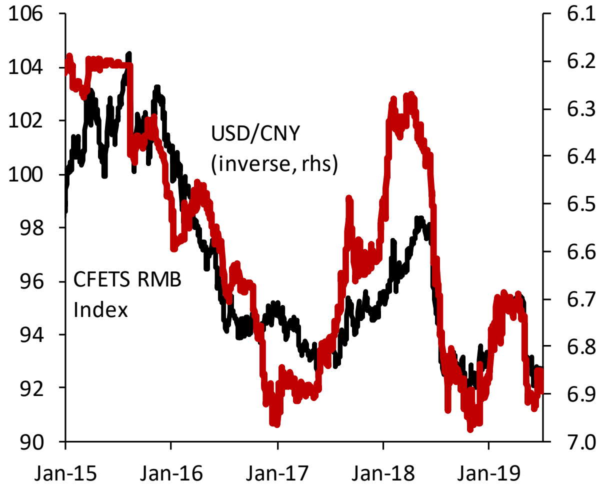


Source: Bloomberg, CEIC, and DBS Group Research

Non-food inflation fell to 1.4% in June from 1.6% YoY in May. Among all, growth in traffic and communication saw more noticeable decline of 1.9%, the most significant drop since May 16. Elsewhere, residential rents also edged down to 2.0%, slowest growth since Apr 12. Core inflation (excluding energy and food prices) stayed at a 33-month low of 1.6% due to subdued income growth. According to the PBoC's Urban Depositor Survey, 29.2% of the respondents expected prices to surge in 2Q, up from 26.8% in 1Q largely driven by rising food prices. In fact, percentage of preference for scaling up savings jumped to the highest level last seen in 1Q15 of 45.4%, leaving smaller room for consumption.

Producer price inflation eased to 0% YOY in June from 0.6% in May (Chart 12)**.** This was the slowest growth since Aug 16. On a MoM basis, the PPI went down by 0.3% from the advancement of 0.2% in May. Performance of upstream industries will continue to moderate (raw materials prices down 2.1% YoY, biggest drop since Aug 16). Chemical PPI went down by 3.8%. Meanwhile, both consumer durables and automobiles went down by 0.9% respectively. Against such a backdrop, industrial profits are set to decline further.

Chart 13: CNY exchange rates



Source: Bloomberg and DBS Group Research

Re-leveraging by the PBOC will eventually add downward pressure to onshore interest rate and CNY exchange rate. Yield of 10-year government bonds already dropped from a year-high of 3.435% to 3.183% of late. CNY has depreciated towards 6.87 from 6.7 against the USD (Chart 13). Yuan could eventually reach the psychological threshold of 7 by the end of 3Q19 in spite of expected rate cuts from the Fed in the US, in our view.

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Sources: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations).

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